18 March 2021

Japan tax alert

Ernst & Young Tax Co.

UK Tax Alert - 2021 Spring Budget: key highlights for Japanese groups

EY Global tax alert library

Access both online and pdf versions of all EY Global Tax Alerts.

- Copy into your web browser:

www.ey.com/en_gl/tax-alerts

On 3 March 2021, the UK Chancellor of the Exchequer, Rishi Sunak, delivered the UK Government's Spring Budget against a backdrop of two competing agendas, the need to provide continuing support and encourage investment in the UK while at the same time starting to return to "sustainable" public finances.

Below are some of the key relevant measures to our Japanese corporate clients, with the most significant being the increase to the upper rate of UK corporation tax to 25% from 1 April 2023, above the 20% Japanese controlled foreign companies (JCFC) trigger rate. While this change is likely to increase the tax burden of UK subsidiaries, there is expected to be a welcome simplification of the JCFC compliance process and a reduction to the risk of passive income attribution to Japanese shareholders.

This year's Spring Budget contains more changes to the UK tax landscape than we have been accustomed to in recent years and will likely have a sizeable impact on Japanese groups operating in the UK. The UK Tax Desk Team, based in Japan, is available to help you understand and manage the impacts that the Spring Budget may have on your business moving forward.

Key takeaways

- The upper UK corporation tax rate will rise to 25% from 1 April 2023 for UK companies with profits in excess of £250,000, still the lowest rate in the G7 but above the JCFC trigger rate. The corporate income tax rate will remain at 19% for UK companies with profits of up to £50,000, with companies with profits between £50,000 and £250,000 paying at a tapered rate.
- For the next two years, companies will be able to carry back up to £2m of losses for up to three years.
- The UK's Diverted Profits Tax rate will increase from 25% to 31% from 1 April 2023.
- The EU Interest and Royalty Directive will be repealed, resulting in withholding tax (WHT) being due on interest and royalty payments to EU jurisdictions where full treaty relief is not available.
- A temporary super deduction (tax depreciation) for expenditure on qualifying plant and machinery, up to 130%, will be available from 1 April 2021 to 31 March 2023.
- Current COVID-19 support will be extended to support businesses.

Detailed announcements impacting Japanese groups

Business taxes

Tax rates

The upper rate of corporation tax will rise to 25% from 1 April 2023 for UK companies with profits in excess of £250,000. It is not confirmed yet, but it should be noted that we expect that the £250,000 threshold will be divided by the number of associated companies, as was previously the case when the UK had an upper and lower tax rate. Therefore, a majority of our clients are likely to fall into the upper band.

A small profits rate of 19% will be introduced for companies with annual profits up to £50,000. Companies with profits between £50,000 and £250,000 will pay a tapered rate, not the full 25%. The small profits rate will not apply to close investment-holding companies.

While the increase to the UK's upper rate of corporation tax will result in an increased tax burden for UK subsidiaries, this change is likely a welcome benefit to many Japanese groups. The UK's corporation tax rate will now be above the lower 20% JCFC trigger rate, resulting in an increased number of UK subsidiaries no longer being subject to the Economic Activity Test and passive income inclusion risk in Japan.

The definition of a large and very large company for the purposes of quarterly installment payments for corporation tax, patent box, etc., will be revised, bringing more companies within the regimes. This change will bring the due date of corporation tax payments forward for a number of businesses, with those now defined as very large likely settling a majority of their tax liability prior to the end of the financial year.

The rate of Diverted Profits Tax (DPT) will increase from 25% to 31% for the financial year beginning 1 April 2023 (maintaining the 6% difference from the main rate).

The bank surcharge (currently 8%) will be reviewed to ensure banks do not pay too much tax following the corporation tax increase in 2023.

Other measures

Loss carry-back: For the next two years, companies will be able to carry back up to £2m of additional losses per year for up to three years, with losses being carried back against later years first. The £2m maximum applies separately to companies' unused trading losses after the uncapped one-year carry-back to the preceding year. For Japanese groups who have seen a significant reduction in profits as a result of the COVID-19 pandemic, this provides a readily accessible cashflow advantage.

Tax depreciation: For the next two years, a super-deduction of 130% will be available to businesses on capital investments. Companies investing in new qualifying plant and machinery assets will be able to claim a 130% super-deduction capital allowance (tax depreciation) and a 50% first-year allowance for qualifying special rate assets. This additional super-deduction could result in a cash tax saving of up to 5.7% on investments made in the UK during the next two years.

In addition, tax sites within the eight newly established freeports will benefit from enhanced Structures and Building Allowances (SBA) of 10%, generally 3%. Also, these sites will benefit from 100% enhanced capital allowances (tax depreciation).

Withholding tax: The Government will legislate to repeal the domestic legislation that gives effect to the EU Interest and Royalties Directive. From 1 June 2021, withholding taxes will apply to payments of annual interest and royalties made to EU companies. Relief is available under the relevant double taxation agreement. Groups that have established a regional financing center in the UK will need to consider these changes as not all treaties result in 0% WHT.

R&D: The Government will undertake a review of R&D tax reliefs to ensure the UK remains a competitive location. In addition, under this review, the Government will determine if certain data and cloud computing costs may be brought within the scope of qualifying expenditure. The UK's R&D scheme is already one of the wider-reaching schemes globally, and any further extension of the scheme will provide a real benefit to Japanese groups intending to undertake R&D activities outside of Japan.

Anti-avoidance – leases: The Government will legislate to turn off certain parts of anti-avoidance legislation affecting leases extended as a result of COVID-19. The easement will restore the eligibility to claim capital allowances.

COVID-19 pandemic support measures

The Coronavirus Job Retention Scheme (''CJRS'') will be extended to the end of September 2021. The scheme was introduced to help companies retain their employees during these challenging times by paying 80% of employees' salaries for hours not worked. From 1 July, businesses will be asked to contribute 10% of salaries, and from 1 August, they will be asked to contribute 20%.

The current Business Rates holiday for the retail, hospitality and leisure sectors in England will be extended until the end of June at a 100% reduction, and then for a further nine months at a 2/3 reduction. Business Rates are a separate levy paid by businesses based on the ratable value of their business premises.

The VAT rate reduction to 5% for the retail, hospitality and leisure sectors will continue until 30 September 2021. It then will be reduced to 12.5% for six months before returning to the standard rate, 20%, from April 2022.

The Coronavirus Business Interruption Loan Scheme (CBILS) and bounce back loan schemes will end; however, a new Recovery Loan scheme will begin on 6 April for businesses of any size and will close at the end of the year. The Government will guarantee 80% of the value of the loans.

Next steps

The Budget did not contain many fundamental changes to overall tax law. However, the number of significant measures introduced which aim to support the UK economy's recovering following a turbulent period since the outbreak of the COVID-19 pandemic will need to be properly managed by Japanese groups operating in the UK. In particular, the rise in the UK corporation tax rate provides a real opportunity for Japanese groups to consider the operating structure in Europe. The interaction of the three-year loss-carry back, the super-deduction and the rate increase could lead to some varied outcomes depending on results and investment. Modeling this position may be a valuable exercise for many Japanese groups. The UK Tax Desk Team based in Japan can help you understand and manage the impact of the recent legislative and business support changes introduced as part of the 2021 Spring Budget may have on your business.

For additional information with respect to this alert, please contact the following:

Contacts

Ernst & Young Tax Co.

Ichiro Suto	Partner	ichiro.suto@jp.ey.com
Jonathon Shepherd	Manager	jonathon.shepherd@jp.ey.com

EY UK

Joachim Stobbs	Partner	jstobbs@uk.ey.com